Bauer

FEDERAL ELECTION COMMISSION
WASHINGTON, D C 20463

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MEMORANDUM

TO: Lawrence H. Norton
General Counsel

THROUGH: James A. Pehrkon
Staff Director

Robert J. Costa
Deputy Staff Director

AUDIT REFERRAL #02-08

FROM: Joseph F. Stoltz
Assistant Staff Director
Audit Division

Thomas J. Nurthen
Audit Manager

Brenda E. Wheeler
Lead Auditor

SUBJECT: Bauer for President 2000, Inc. — Referral Matters

On May 31, 2002, the Commission approved the audit report on Bauer for President 2000, Inc. The audit report was released to the public on June 19, 2002. In accordance with the Commission approved materiality thresholds, the attached findings from the audit report are being referred to your office.

Finding II.A. – Apparent Impermissible Contributions (Sections A.1. – A.3.)
Finding II.E. – Apparent Prohibited Contributions Resulting from Extensions of Credit by Commercial Vendor

All workpapers and related documentation are available for review in the Audit Division. Should you have any questions, please contact Brenda Wheeler or Tom Nurthen at 694-1200.

Attachments:
Finding II.A. – Apparent Impermissible Contributions, pp. 7-15
Finding II. E. – Apparent Prohibited Contributions Resulting from Extensions of Credit by Commercial Vendors, pp. 20-23

A. APPARENT IMPERMISSIBLE CONTRIBUTIONS

Section 431(8)(A)(i) of Title 2 of the United States Code states in part, that a contribution includes a gift, subscription, loan, advance, or deposit of money or anything of value for the purpose of influencing a Federal election.

Section 441a(a)(1)(A) of Title 2 of the United States Code states, in part, no person shall make contributions to any candidate and his authorized committees with respect to any election for Federal office which, in the aggregate, exceed $1,000.

Section 441a(a)(2)(A) of Title 2 of the United States Code states, in part, no multicandidate political committee shall make contributions to any candidate and his authorized committees with respect to any election for Federal office which, in the aggregate, exceed $5,000.

Section 100.7(a)(1)(i)(A) and (B) of Title 11 of the Code of Federal Regulations states in part, that a loan, which exceeds the contribution limitations, shall be unlawful whether or not it is repaid. A loan is a contribution at the time it is made and is a contribution to the extent that it remains unpaid. The aggregate amount loaned to a candidate or committee by a contributor, when added to other contributions from that individual to that candidate or committee, shall not exceed the contribution limitations set forth at 11 CFR part 110.

Section 100.7(a)(1)(iii)(A) and (B) of Title 11 of the Code of Federal Regulations provides, in part, any goods or services without charge or at a charge which is less than the usual and normal charge for such goods or services is a contribution. If goods or services are provided at less than the usual and normal charge, the amount of the in-kind contribution is the difference between the usual and normal charge for the good and services at the time of the contribution and the amount charged the political committee. Usual and normal charge for goods or services means the price of those goods in the market from which they ordinarily would have been purchased at the time of the contribution.

Section 100.7(a)(2) of Title 11 of the Code of Federal Regulations states the entire amount paid to attend a fundraiser or other political event and the entire amount paid as the purchase price for a fundraising item sold by a political committee is a contribution.

Section 110.10(b)(1) and (3) of Title 11 of the Code of Federal Regulations defines personal funds of the Candidate to mean any assets which, under applicable state law, at the time he or she became a candidate, the candidate had legal right of access to or control over, and with respect to which the candidate had either legal and rightful title or an equitable interest. A candidate may use a portion of assets jointly owned with his or her spouse as personal funds. The portion of the jointly owned assets that shall be considered as personal funds of the candidate shall be that portion which is the candidate's share under the instrument(s) of conveyance or ownership. If no specific share is indicated by an instrument of conveyance or ownership, the value of one-half of the property used shall be considered as personal funds of the candidate.

Sections 9035.2(a)(1) and (c) of Title 11 of the Code of Federal Regulations state, no candidate who has accepted matching funds shall knowingly make expenditures from his or her personal funds, or funds of his or her immediate family, in connection with his or her campaign for nomination for election to the office of President which exceed $50,000, in the aggregate. This section shall not operate to prohibit any member of the candidate's immediate family from contributing his or her personal funds to the candidate, subject to the limitations of 11 CFR part 110. The provisions of this section also shall not limit the candidate's liability for, nor the candidate's ability to pay, any repayments required under 11 CFR part 9038. If the candidate or his or her committee knowingly incurs expenditures in excess of the limitations of 11 CFR 110.8(a), the Commission may seek civil penalties under 11 CFR part 111 in addition to any repayment determinations made on the basis of such excessive expenditures. For purposes of this section, personal funds have the same meaning as specified in 11 CFR 110.10.

Section 441b(a) of Title 2 of the United States Code states, in part, that it is unlawful for any corporation to make a contribution or expenditure in connection with any election to federal office and that it is unlawful for any candidate, political committee or any other person knowingly to accept or receive any contribution prohibited by this section.

1. Donor List

The Candidate formed Campaign for Working Families PAC (CWF) in 1996. CWF registered as a political committee with the Commission in November 1996 and qualified for multicandidate status in August 1997. During the 2000 election cycle, CWF reported $2,728,839 in receipts. CWF maintains a donor list and markets the list in the *SRDS Direct Marketing List Source*. According to the December 1998 through December 1999 issues, CWF's donor list, which consists of 137,120 donors and responders, rents for $115 per 1,000 names with a minimum order of 5,000 names. The publication identifies the list manager as Pinnacle List Company.

On January 3, 2000, the Committee received $70,000 from The Lukens Cook Company (Lukens).[1] A written agreement, dated December 30, 1999, signed by representatives of the Committee and Lukens stipulated that for compensation of $70,000 Lukens had "exclusive rights to market, rent or exchange the complete Bauer for President donor file either in part or in total," for a period of 8 1/2 months starting January 15, 2000 through October 1, 2000. The complete file, according to the agreement, consisted of 63,281 donors and 20,000 non-donors. The agreement also granted CWF (through the Committee) "five full uses" of the donor file during a specific time period to **"fulfill its exchange obligation to Campaign for Working Families."** (Emphasis added).

The agreement, at item 6, references a prior agreement. It states, "per prior agreement, at the termination of this agreement, on October 1, 2000, Lukens shall retain a permanent joint ownership right to that portion of the Bauer for President donor file **that did not originate as donors to Campaign for Working Families."** (Emphasis added). This language indicates that the Committee had access to a CWF donor file.

Other than a payment representing the purchase of campaign materials and equipment[2], the Committee did not make any additional payments to CWF. Further, the Committee has not reported any debt owed to CWF relative to this transaction even though it is apparent from the language in the agreement that an obligation existed at some point in time.

On November 15, 2000, the Audit staff issued a written request for information and documentation concerning the Committee's "exchange obligation" to CWF. The Committee did not respond to this inquiry. The matter was then addressed at the exit conference. Committee representatives stated they were continuing to gather information and were not prepared to respond Further, the Committee did not submit

1 Lukens also served as one of the Committee's direct mail vendors During the audit period, the Committee paid Lukens $258,699 for direct mail service

2 A donor list was not part of this purchase

any documentation during the response period subsequent to the exit conference.[3] As a result, on March 8, 2001, the Audit staff requested subpoenas and interrogatories be issued to the Committee, CWF, Lukens and the Pinnacle List Company (Pinnacle). The Commission approved the subpoenas and interrogatories on April 5, 2001.

The entities were asked to produce documentation and/or answer questions relative to the CWF mailing list made available to the Committee. In response, the Committee and CWF provided an exchange agreement. Under the agreement Pinnacle coordinated use of CWF's file (by the Committee) and kept the exchange history. The Committee received a complete copy of CWF's donor (87,013) and non-donor (51,507) files. The first use occurred on February 5, 1999. In exchange, the Committee would provide CWF with a complete copy of its donor and non-donor files at the end of the campaign. When the Committee wanted to use the CWF files, it submitted a "request to mail form" accompanied by a copy of the mailing. Upon approval by CWF, the Committee pulled "selects"[4] from its copy of the CWF files and provided the output counts to Pinnacle. Finally, all CWF names remained the sole property of CWF, any and all Committee names remained the property of the Committee.

The provision of a mailing list at less than the usual and normal charge is an in-kind contribution within the meaning of 11 CFR §100.7(a)(1)(iii)(A). Furthermore, in Advisory Opinion 1981-46 the Commission addressed list exchanges and determined, "if the exchange of names is of equal 'value' according to accepted industry practice, the exchange would be considered full consideration for services rendered. Thus, no contribution or expenditure would result and the transaction would not be reportable under the Act." The Commission also took the position that, "when the Committee provides names to another political committee in exchange for its own future use of a corresponding number of names which are of equal value, that this constitutes an arms (sic) length business transaction between the committees and is not a reportable contribution under the Act."

According to Pinnacle, the list manager for both the Committee and CWF, the Committee used the CWF files 22 times during the period February 5, 1999 through February 28, 2000, for an aggregate mailing of 957,338 names. Therefore, in order for the exchange to be considered equal and not result in a contribution by CWF, the Committee would have to make available (to CWF) use of "pure" Committee donor file names (i.e., names not included in CWF's donor and non-donor files at the time CWF's list was obtained by the Committee) that, based on the number of CWF uses, in the aggregate, had value equal to the value of the 957,338 names used by the Committee.

CWF provided documentation that demonstrated "in exchange" it used the Committee's donor file, consisting of 25,547 names, a total of 8 times during the

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3 Committees are provided ten business days subsequent to an exit conference to provide documentation relative to potential audit findings The Committee did not avail itself this opportunity to respond to any matter discussed at the exit conference

4 Selects are characteristics that identify segments or subgroups within a list

period June 2000 to February 2001 for an aggregate mailing of 174,501 names. As of May 2001, the Committee's exchange obligation to CWF was 782,837 names (957,338 – 174,501).

According to industry sources, CWF rents its mailing list for $115 per 1,000 names (minimum of 5,000 names). The Committee rents its mailing list for $130 per 1,000 names. Therefore, the fair market value that an entity would pay for the use of 957,338 names from CWF's donor files would be $110,094 (957,338 / 1,000 x $115). Likewise, the fair market value that an entity would pay for the use of 174,501 names from the Committee's donor files would be $22,685.

The preliminary audit report stated that it was the opinion of the Audit staff that the "exchange" between CWF and the Committee did not represent an arm's length transaction according to industry standards. As a result, CWF made and the Committee received an apparent excessive in-kind contribution of $87,409 ($110,094 - $22,685). The Audit staff recommended the Committee provide evidence that CWF did not make and the Committee did not accept an excessive in-kind contribution of $87,409. Such evidence was to demonstrate that the exchange was of equal value according to industry standards. Absent such evidence, a refund $87,409 was to be made to CWF and evidence provided. If funds were not available to make the refund, the Committee was to disclose on Schedule D (Debts and Obligations) as debt owed to CWF until such time that funds become available.

In response to the preliminary audit report, the Committee's Counsel asserted:

> "[the] Audit Staff makes no effort to determine the 'value' of the 'future' use of the names expected to be generated by the Committee at the time the exchange agreement was made. Instead, its analysis rests on a comparison of CWF's 'actual use' of the Committee's list versus the Committee's actual use of CWF's list. What CWF chose to do during the term of the agreement, however, does not establish the value of its right to the 'future use' of the potential Committee's list, at the time of the exchange agreement, which is the relevant time for the valuation of the exchange. The Committee submits that, judged by industry standards, CWF's right to use the potentially very large number of new names that the parties anticipated that the Committee would generate more than equaled the value of the right to use the names CWF proposed to provide to the Committee. Moreover, use of the list by the Committee added value to the CWF list."

Counsel is correct in stating that the Audit staff made no effort to determine the "value" of the "future" use of the names expected to be generated by the Committee. Such an effort could never produce a reliable result. Counsel appears to be saying that had the campaign been more successful, its fundraising efforts would have generated more names to exchange with CWF, resulting in an equal exchange of names between the Committee and CWF. The Audit staff analyzed only the facts as they existed and concluded the exchange between the Committee and CWF was not equal and resulted in an excessive contribution.

As previously stated, the Commission, in AO 1981-46, recognized two acceptable industry standards of list exchange: first, if the exchange of names is of equal 'value' according to accepted industry practice; and, second, when a committee provides names to another political committee in exchange for its own future use of a corresponding number of names which are of equal value. Counsel offers no evidence that the exchange of names between the Committee and CWF was of equal value. Counsel merely suggests that had the Committee generated more names, the exchange would have been in accordance with industry standards. The fact remains the exchange was not equal. As a result, the Committee has not demonstrated that CWF did not make and the Committee did not accept an excessive in-kind contribution of $87,409.

2. Rental of Donor List

As previously stated in Section II.A.1., Lukens rented the Committee's complete donor file for the period January 15, 2000 through October 1, 2000 for $70,000. Lukens paid the Committee on January 3, 2000. At that time of this payment, the Candidate was actively campaigning and received his first matching fund payment of $1,969,167, also on January 3, 2000. In accordance with 11 CFR §100.7(a)(2), the entire amount paid as the purchase price for a fundraising item sold by a political committee is a contribution. However, the Commission has published a number of advisory opinions relative to the sale or rental of committee assets. In those advisory opinions, the Commission generally has viewed such ventures by on-going committees simply as another form of fundraising for political purposes in which the proceeds result in contributions subject to the Act (Advisory Opinions 1983-2, 1981-7, 1980-70, 1980-34, 1980-19, 1979-76, and 1979-17). The Commission also has recognized a narrow, limited exception, where the asset involved was a political committee's mailing or contributor list that had a unique quality and was developed by the political committee in the normal course of its operations primarily for its own use, rather than as an item to be sold to others as part of a campaign fundraising activity (Advisory Opinions 1982-41, 1981-53, 1981-46 and 1979-18).

The rental of the Committee's complete donor file to Lukens does not appear to fall under the narrow, limited exception described in the four advisory opinions cited above. It appears questionable that this donor file can be considered developed by the Committee in the normal course of its operations. Of the 63,281 donors and 20,000 non-donors rented to Lukens, only 25,547 names (31%) were not names obtained from CWF. Furthermore, at the time the donor file was rented to Lukens

(January 2000), the Committee had still not paid CWF and the exchange process did not begin until June 2000, approximately 6 months after the list was rented to Lukens.

More importantly, the rental to Lukens fails to meet the operative language contained in the exception that the donor file was "primarily for its own use, rather than as an item to be sold to others as part of a campaign fundraising activity." As previously stated, in January 2000, the Committee was still active and raising funds. The same day the Committee received $70,000 from Lukens (January 3rd), it received its first matching fund payment of $1,969,127. No state primary or caucus had occurred.

It is the opinion of the Audit staff that the funds received from Lukens are subject to the prohibitions and limitations of the Act. As a result, Lukens made and the Committee received a prohibited contribution of $70,000.[5]

In the preliminary audit report, the Audit staff recommended that the Committee provide evidence that Lukens did not make and the Committee did not accept a prohibited contribution of $70,000. Such evidence was to demonstrate that Lukens is not a corporation and that the $70,000 payment by Lukens did not result in a contribution to the Committee. For example, documentation was to demonstrate that Lukens used or marketed the list during the rental period. Further, the documentation was to show that the Committee's donor file was developed in the normal course of its operations and primarily for its own use, rather than as an item to be sold to others or for use in a campaign fundraising activity. Absent such evidence, it was recommended that the Committee disgorge $70,000 to the United States Treasury.

In response, the Committee's Counsel neither submitted any documentation requested nor made a payment to the United States Treasury. Rather the response maintains:

> "The Audit Staff's conclusion that the Committee's list was not 'developed for its own use,' but rather as a fundraising item, is unsupportable in light of Mr. Bauer's active candidacy in the 2000 Presidential election. Moreover, the Audit Staff has misconstrued the arrangement between Lukens and the Committee with respect to the rental of names. In any event, the Audit Staff's suggestion that names obtained initially from third parties do not qualify 'as developed' by the Committee is contrary to industry practice, a practice that has not been questioned previously by the Commission."

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5 According to Dun & Bradstreet, Lukens incorporated in the State of Virginia on July 27, 1987 According to the Corporation Division of the Virginia Secretary of State's Office, Lukens is not listed as a corporation However, its current business license was issued by the City of Alexandria The name on the business license is The Lukens Cook Company, Inc.

Counsel offered no evidence that the Committee's list was "developed for its own use," rather than as a fundraising item. Nor did Counsel offer any documentation to support its own statement that the Audit staff "misconstrued the arrangement between Lukens and the Committee with respect to the rental of names."

Factually, this transaction and the agreement between Lukens and the Committee demonstrates that an asset of the Committee that is normally used to solicit contributions, was placed with a vendor to be marketed to all interested parties. As a result, the proceeds from this specific transaction represent a contribution to the Committee, subject to the limitations and prohibitions of the Act. As a result, the Committee has not demonstrated that Lukens did not make and it did not receive and prohibited contributions of $70,000.

The Commission voted to receive this finding without any determination on the merits of the analysis of the facts or the interpretation of the law contained therein.

3. Purchase of Assets

The Committee purchased office equipment, furniture, supplies and printed materials from CWF for $15,372 on June 28, 1999. The Bill of Sale, although not dated, was annotated "prepared by CWF 3/16/99" and faxed to the Committee on June 28, 1999.

Since the Committee did not pay CWF until June 28, 1999, CWF made a contribution to the Committee equal to the value ($15,372) of the assets for the period March 16, 1999, through June 28, 1999.[6] Consequently, an excessive contribution of $14,372 ($15,372 [value of assets] - $5,000 [limit] + $4,000 [contribution on 1/29/99]) occurred as a result of this transaction.

In the preliminary audit report, the Audit staff recommended that the Committee provide evidence to demonstrate that CWF did not make an excessive contribution of $14,372. Additionally, the Audit staff requested the terms of the agreement between the two parties, if any, and the date that the Committee took possession of the assets.

In response, the Committee disputed the Audit staff's conclusion. The Committee's Counsel asserted that it, "has not yet located additional documentation, although efforts to do so have been made and will continue to be made. The material will be supplied promptly upon receipt."

To date, the Committee has not provided evidence or documentation demonstrating that CWF did not make an excessive contribution of $14,372. Nor has the Committee provided documentation regarding the terms of any

[6] Although requested, the Committee did not provide documentation demonstrating the exact date it took possession of the above items

agreement between the parties or the date the Committee took possession of the assets. As a result, the Audit staff's position that CWF made and the Committee accepted an excessive contribution of $14,372 remains unchanged.

The Commission voted to receive this finding without any determination on the merits of the analysis of the facts or the interpretation of the law contained therein.

invoices were "payable upon receipt." Based on records made available and discussions with Committee representatives, it does not appear that the vendor sent subsequent invoices or made additional attempts to collect the amounts due.

Based upon the above, it is the opinion of the Audit staff that Moore Response Marketing Services' extension of credit was not in the ordinary course of business and resulted in a prohibited contribution of $124,089 ($114,045 + $10,044) for the period the invoices remained outstanding.

3. RST Marketing Associates, Inc. (RST)

RST also direct mail vendor, billed the Committee $1,149,315. Twelve invoices totaling $342,613 were not paid timely.

Seven invoices in amounts ranging from $1,500 to $12,000 remained outstanding between 134 to 164 days. The remaining five invoices in amounts between $40,000 and $93,000 remained outstanding between 103 and 195 days.

According to the terms noted on the invoices, payment was "due in 30 days." Based on records made available and discussions with Committee representatives, it does not appear that the vendor sent subsequent invoices or made additional attempts to collect the amounts due. The Committee did report the amounts as debts owed by the Committee on Schedules D-P, (Debts and Obligations).

Based upon the above, it is the opinion of the Audit staff that RST's extension of credit was not in the ordinary course of business and resulted in a prohibited contribution of $342,613 for the period the invoices remained outstanding.

In the preliminary audit report, the Audit staff recommended that the Committee provide additional documentation, which was to include statements from the vendors that demonstrated the credits extended were in the normal course of the vendor's business and did not represent a prohibited contribution by the vendors. The information provided was to include examples of other non-political customers and clients of similar size and risk for which similar services have been provided and similar billing arrangements have been used. It was also recommended that the Committee provide information concerning the vendor's billing policies for similar nonpolitical clients and work, advance payment policies, debt collection policies, and billing cycles

In its response the Committee stated that it:

> "disputes the contention that it received an in-kind contribution from any of the listed vendors or that it received credit other than in the ordinary course of business. The Committee has sought to obtain the documentation indicated by the Commission, but has not yet been able to do so. The Committee will submit such documentation promptly upon receipt. The Committee